CITY OF LODI

COUNCIL COMMUNICATION

AGENDA TITLE: Adopt resolutions of the City of Lodi declaring its intent to reimburse certain expenditures from proceeds of indebtedness for City facilities (Public Safety, Parks and Recreation, and general government projects)

MEETING DATE: June 6, 2001

PREPARED BY: City Manager

RECOMMENDED ACTION: That the City Council adopt the attached resolutions declaring its intent to reimburse certain expenditures from proceeds of indebtedness for City facilities.

BACKGROUND INFORMATION: It is anticipated that the City of Lodi will soon enter into design phases for a number of projects including the Public Safety Complex, Animal Shelter, parking structure, an indoor sports facility, an aquatics center, and various other parks projects. In order to recapture what are deemed "reimbursable expenses" from future bond proceeds, it is necessary for the Council to adopt resolutions declaring this intent. Typical reimbursable expenses include design, property acquisition and construction costs.

The attached resolutions do not commit the City to make any expenditures, incur any indebtedness, or proceed with the projects. The resolutions simply provide the City with the ability to seek reimbursements for costs, already incurred and future costs, should the City proceed with Certificates of Participation in the future. This declaration is made solely for the purpose of establishing compliance with the requirements of Section 1.150-2 of the Treasury Regulations.

FUNDING: Not applicable.

Respectfully,

H. Dixon Flynn
City Manager

Prepared by: Janet S. Keeter, Deputy City Manager
Roger Baltz, Parks & Recreation Director

JSK/jlt

APPROVED: ______________________
H. Dixon Flynn -- City Manager

ORRICK

REIMBURSEMENT REGULATIONS

Use of Tax-Exempt Bond Proceeds to Reimburse Prior Expenditures

I. INTRODUCTION

Issuers of tax-exempt bonds ("Bonds") often wish to use Bond proceeds to reimburse themselves for costs paid prior to the issuance of the Bonds. Bond proceeds allocated to such "Reimbursement Costs" will be treated as "spent" only if the requirements of Treasury Regulations Section 1.150-2 (the "Reimbursement Regulations") are satisfied.[1] If these requirements are not satisfied, any Bond proceeds that the issuer attempts to allocate to Reimbursement Costs will continue to be subject to the yield restriction rules and the rebate requirement of Section 148 of the Internal Revenue Code of 1986 (the "Code"). The investment earnings (actual or imputed) on such a unspent Bond proceeds may result in unanticipated rebate liability or cause the Bonds to become taxable. The requirements of the Reimbursement Regulations are summarized below.

II. GENERAL RULES

In addition to limiting the types of costs that Bond proceeds may be used to reimburse,[2] the Reimbursement Regulations generally impose two requirements on Bonds the proceeds of which are to be used to reimburse pre-issuance costs i.e., "Reimbursement Bonds"). First, the issuer[3] must demonstrate that an intent to reimburse the cost (with proceeds of a borrowing) existed at or around the time the cost was paid (this requirement is referred to as the "Official Intent Requirement"). Second, the

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1 The Reimbursement Regulations constitute a significant rewrite of the previous reimbursement rules. See Orrick, Herrington & Sutcliffe *Municipal Finance Report*, Vol. 91-2 (May 1991).

2 See Section IV below.

3 Under the Reimbursement Regulations: (i) for governmental bonds and qualified 501(c)(3) bonds, the "issuer" is either the entity that actually issues the bonds or the conduit borrower (to the extent the bond proceeds are loaned to such borrower); and (ii) for private activity bonds other than 501(c)(3) bonds, the "issuer" is the entity that actually issues the bonds.

Reimbursement Bond proceeds must be allocated to the Reimbursement Cost within a specified time period after the cost was paid or the financed facility placed in service or abandoned (this requirement is referred to as the "Reimbursement Period Requirement").

The Reimbursement Regulations also provide certain exceptions to the Official Intent Requirement and to the Reimbursement Period Requirement. In particular, certain "preliminary" or "soft" costs are not subject to either requirement (this exception is referred to as the "Preliminary Expenditures Exception").[4]

III. Bonds Affected

The Reimbursement Regulations were released by the Treasury Department on June 14, 1993[5] and are generally applicable to Bonds issued after June 30, 1993. Even if the Official Intent Requirement is not actually satisfied, Bonds issued after June 30, 1993 will be treated in certain cases as satisfying the Reimbursement Regulations.[6]

Previous versions of the reimbursement regulations applied only to (i) governmental bonds (i.e., non-private activity bonds); (ii) qualified 501(c)(3) bonds; and (iii) private activity bonds the proceeds of which are used to finance a facility owned by a governmental unit. "Reimbursement" with proceeds of other tax-exempt bonds was previously governed by the basic official action rules of Treasury Regulations Section 1.103-8(a)(5). In contrast, the Reimbursement Regulations are intended to provide the operating rules for all allocations of Bond proceeds to pre-issuance costs, regardless of the type of Bonds in question.

IV. Nature Of Expenditure

Reimbursement Bond proceeds will be treated as "spent" only if the corresponding Reimbursement Cost is (i) a capital expenditure; (ii) a cost of issuance of a bond; (iii) an extraordinary working capital item; (iv) a grant; (v) a qualified student loan;

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4 See Section VII below.

5 Section 1.150-2 was issued in T.D. 8476, along with other final regulations relating to arbitrage restrictions.

6 In particular, proceeds of Reimbursement Bonds will be treated as "spent" if such proceeds are allocated to Reimbursement Costs paid after (i) the adoption of a declaration so long as such declaration was adopted prior to July 1, 1993 and satisfied the basic official action requirements of Treasury Regulations Section 1.103-8(a)(5) as in effect prior to July 1, 1993; or (ii) the adoption of a reimbursement declaration so long as such declaration was adopted between January 27, 1992 and June 30, 1993 and satisfied the requirements of the prior regulations on reimbursement financings in Treasury Regulations Section 1.103-18. Treas. Reg. § 1.150-2(j)(2).

(vi) a qualified mortgage loan; or (vii) a qualified veterans' mortgage loan. An "extraordinary working capital item" is an expenditure for an extraordinary, nonrecurring item that is not customarily payable from current revenues. Examples of extraordinary working capital items include casualty losses or extraordinary legal judgments in excess of reasonable insurance coverage. A "grant" is a transfer for a governmental purpose of money or property to a transferee that is neither a related person to nor an agent of the transferor.

V. *Official Intent Requirement*

Under the Official Intent Requirement, the issuer must adopt an official intent no later than 60 days after the Reimbursement Cost in question was paid.[7] The official intent must satisfy the following requirements:

A. *Form of Official Intent*

Generally, the official intent may be adopted by the issuer[8] in "any reasonable form." For example, the governing board of the issuer may adopt resolution stating the issuer's official intent. Alternatively, the governing board may delegate the authority to declare official intent on behalf of the issuer to an individual.[9]

B. *Project Description*

The declaration must generally describe the project and must state the maximum principal amount of obligations expected to be issued for the project. Any property, project, or program may be a "project." Examples include highway capital improvement programs, hospital equipment acquisition, and school building renovation. Because the purpose of the Reimbursement Regulations is to establish a nexus between the Reimbursement Bonds and the Reimbursement Costs, the more specific and detailed the project description the less likely the official intent will be challenged.[10]

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7 The ability to adopt the official intent after the expenditure represents an important change a from prior regulations.

8 For qualified 501(c)(3) bonds, the "issuer" is either the entity that actually issues the bonds or the conduit 501(c)(3) borrower.

9 Section 1.150-2 states that specific legislative authorization for the issuance of obligations for a particular project will constitute official intent.

10 Issuers should take care not to inadvertently exclude any projects from the project description.

1. Fund Accounting

As an alternative to describing the project itself, Issuers may identify the fund or account from which the Reimbursement Cost was paid. The fund or account must be identified by name and functional purpose. For example, the issuer may state that the Reimbursement Cost was paid from the "parks and recreation fund - recreational facility capital improvement program."[11] Under this alternative, the official intent should still state the maximum principal amount of obligations expected to be issued.

2. Reasonable Deviations From Project Description

So long as the actual project on which Reimbursement Costs were incurred is reasonably related in function to the project described in the official intent, deviations between the actual project and project described in the official intent are permitted. An example of a reasonable deviation is the reimbursement of costs of hospital equipment while the official intent described the project as "hospital building improvements." In contrast, an issuer that sought to reimburse costs of city building rehabilitation while the official intent described the project as "highway improvements" would not satisfy the Official Intent Requirement.

C. Reasonableness of Official Intent

On the date that the issuer states its official intent, the issuer must have a reasonable expectation that it will reimburse the cost in question with proceeds of a borrowing.[12] The Reimbursement Regulations state that official intents declared as a matter of course or in amounts substantially greater than expected to be necessary for the project (e.g., blanket resolutions) will not satisfy the Official Intent Requirement. However, a pattern of failure to reimburse actual costs covered by an official intent is only evidence of unreasonableness.[13]

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[11] Treas. Reg. § 1.150-2(e)(2)(ii).

[12] An issuer's expectations are reasonable only if a prudent person in the same circumstances as the issuer would have those same expectations, based on all the facts and circumstances. Factors for determining whether an expectation is reasonable include the (i) issuer's history of conduct concerning stated expectations made in connection with the issuance of obligations; (ii) level of inquiry by the issuer into factual matters; and (iii) existence of covenants, enforceable by bondholders, that require implementation of specific expectations. For a financing involving a conduit borrower, the reasonable expectations of the conduit borrower are relevant in determining the reasonableness of the issuer's expectations, so long as it reasonable and prudent for the issuer to rely upon the borrower's expectations. Treas. Reg. § 1.148-1(b).

[13] Specific legislative authorization (see Footnote 6 above) is rebuttably presumed to be reasonable.

Unlike prior versions of the regulations, the Reimbursement Regulations do not explicitly require an official intent to be consistent with the issuer's budgetary and financial circumstances.[14] One consequence is that issuers with large rolling capital budgets and large cash flows may now satisfy the Official Intent Requirement.

VI. Reimbursement Period Requirement

Except for Bond issues that qualify for the $5 million rebate exception, Reimbursement Bond proceeds must be used to reimburse a cost no later than 18 months[15] after the later of (i) the date the cost is paid, or (ii) the date the project is placed in service or abandoned (but in no event more than 3 years[16] after the cost is paid). For this purpose, a facility is not placed in service before it Operates at substantially its design level.

VII. Exceptions

The Reimbursement Regulations provide two exceptions: (i) a de minimis exception, and (ii) the Preliminary Expenditures Exception. Each of these exceptions is an exception to both the Official Intent Requirement and the Reimbursement Period Requirement.

The de minimis exception applies (i) to costs of issuing the Bonds <u>and</u> (ii) to an amount not to exceed the lesser of $100,000 or 5 percent of the proceeds of the Bonds.

The Preliminary Expenditures Exception applies to "soft costs" (such as architectural, engineering, surveying, soil testing, reimbursement bond issuance, and similar costs incurred prior to the commencement of acquisition or construction or

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14 The explicit consistency requirement is replaced by the anti-abuse rules discussed in Section IX below.

15 In the case of an issue which qualifies for the $5 million rebate exception, this period is extended to 3 years. To qualify for the $5 million rebate exception (i) the issuer must be a governmental unit with general taxing powers; (ii) no bond may be a private activity bond; (iii) 95 percent of more of the net proceeds of the Bonds are to be used for local governmental activities of the issuer (or of a governmental unit the jurisdiction of which is entirely within the jurisdiction of the issuer); and (iv) the aggregate face amount of all tax-exempt bonds (other than private activity bonds) to be issued by the issuer during the calendar year in which the Bonds are issued is not reasonably expected to exceed $5 million. Code § 148(f)(4)(D). Tax-exempt obligations issued by certain subordinate governmental units will count toward this $5 million limit.

16 Extended to 5 years if both the issuer and a licensed architect or engineer certify that at least 5 years are needed to complete construction of the project.

rehabilitation of the project). Land acquisition, site preparation, and similar costs incident to commencement of construction do not qualify as "preliminary expenditures." Amounts qualifying under the Preliminary Expenditures Exception may not exceed 20 percent of the aggregate issue price of the issue or issues that finance or are reasonably expected to finance the project for which the preliminary expenditures were incurred.[17] Thus, the 20 percent limit is measured on a project-by-project, not issue-by-issue, basis. An issue of Bonds may finance only Preliminary Expenditures of a project, so long as other issues are issued or reasonably expected to be issued to finance "hard costs" of the project.

VIII. Refundings

Assume the following: (i) the issuer pays costs of a project; (ii) the issuer later issues bonds (the "Prior Bonds") and uses the Prior Bond proceeds to reimburse itself for those costs; and (iii) the issuer later issues more bonds (the "Refunding Bonds") to refund the Prior Bonds. Regardless of whether the Refunding Bonds satisfy the Reimbursement Regulations, the Prior Bond proceeds will be treated as "spent" on the project costs only if the purported reimbursement complied with the reimbursement rules that applied at the time the Prior Bonds were issued. Except for this rule, refundings are to be analyzed not under the Reimbursement Regulations but under Treasury Regulations Section 1.148-9 relating to refundings.

IX. Anti-Abuse Rules

Assume the following: (i) Reimbursement Bond proceeds are allocated to a cost, and (ii) less than a year later, an amount corresponding to the amount of such proceeds are used in a manner that creates "replacement proceeds" of the reimbursement Bonds or another issue (e.g., amounts corresponding to proceeds allocated to reimbursement are deposited in a sinking fund or reserve fund for another issue of tax-exempt bonds within one year of the purported allocation). The Reimbursement Regulations provide that the allocation of the Reimbursement Bond proceeds to project costs will be invalid and the proceeds so "allocated" will not be treated as "spent."[18] As

[17] Soft costs in excess of the 20% limit may be reimbursed only if the Official Intent Requirement and Reimbursement Period Requirement are satisfied with respect to such excess costs (or the de minimis exception is applied).

[18] This rule does not apply to amounts held in a bona fide debt service fund. A bona fide debt service fund is a fund that (i) is used primarily to achieve a proper matching of revenues with principal and interest payments within each bond year; and (ii) is depleted at least once each bond year, except for a reasonable carryover amount not to exceed the greater of (A) the earnings on the fund for the immediately preceding bond year, or (B) one-twelfth of principal and interest payments on the Bonds for the immediately preceding bond year. Treas. Reg. § 1.148-1(b).

replacement proceeds, such amounts will be subject to arbitrage yield and rebate restrictions. [19]

The application of the anti-abuse rules, particularly with respect to the creation of other replacement proceeds, may give rise to complex questions. Issuers should consult with bond counsel to identify and resolve these question.

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19 The Reimbursement Regulations provide the following example of the creation of replacement proceeds:

> On January 1, 1994, County A issues an issue of 7 percent tax-exempt bonds (the 1994 issue) and makes a purported reimbursement allocation to reimburse an original expenditure for specified capital improvements. A immediately deposits funds corresponding to the proceeds subject to the reimbursement allocation in an escrow fund to provide for payment of principal and interest on its outstanding 1991 issue of 9 percent tax-exempt bonds (the prior issue). The use of amounts corresponding to the proceeds of the reimbursement bonds to create a sinking fund for another issue within 1 year after the purported reimbursement allocation invalidates the reimbursement allocation. The proceeds retain their character as unspent proceeds of the [1994 issue] upon deposit in the escrow fund. Accordingly, the proceeds are subject to the 7 percent yield restriction of the 1994 issue instead of the 9 percent yield restriction of the prior issue.

Treas. Reg. § 1.150-2(h)(2)(ii).

RESOLUTION NO. 2001-145

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF LODI DECLARING ITS INTENT TO REIMBURSE CERTAIN EXPENDITURES FROM PROCEEDS OF INDEBTEDNESS (PUBLIC SAFETY PROJECT)

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WHEREAS, the City of Lodi ("City") intends to construct a new Public Safety Building, including a jail and other related facilities and to remodel the existing Public Safety Building to accommodate varied municipal uses within its City limits ("Project"); and

WHEREAS, the City expects to pay certain expenditures ("Reimbursement Expenditures") in connection with the Project prior to the issuance of indebtedness for the purpose of financing costs associated with the Project on a long-term basis; and

WHEREAS, the City reasonably expects that debt obligations in an amount not expected to exceed $15,000,000 will be issued and that certain of the proceeds of such debt obligations will be used to reimburse the Reimbursement Expenditures.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Lodi that:

Section 1. City finds and determines that the foregoing recitals are true and correct.

Section 2. This declaration is made solely for purposes of establishing compliance with the requirements of Section 1.150-2 of the Treasury Regulations. This declaration does not bind City to make any expenditure, incur any indebtedness, or proceed with the Project.

Section 3. City hereby declares its official intent to use proceeds of indebtedness to reimburse itself for Reimbursement Expenditures.

Section 4. This resolution shall take effect from and after its adoption.

Dated: June 6, 2001

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I hereby certify that Resolution No. 2001-145 was passed and adopted by the Lodi City Council in a regular meeting held June 6, 2001 by the following vote:

AYES:	COUNCIL MEMBERS – Howard, Land, Pennino and Mayor Nakanishi
NOES:	COUNCIL MEMBERS – Hitchcock
ABSENT:	COUNCIL MEMBERS – None
ABSTAIN:	COUNCIL MEMBERS – None

Susan J. Blackston

SUSAN J. BLACKSTON
City Clerk

RESOLUTION NO. 2001-146

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF LODI DECLARING ITS INTENT TO REIMBURSE CERTAIN EXPENDITURES FROM PROCEEDS OF INDEBTEDNESS (PARKS AND RECREATION PROJECTS)

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WHEREAS, the City of Lodi ("City") intends to construct Parks and Recreation facilities to include an indoor sports complex, but not limited to an indoor sports complex, an aquatics center, and an outdoor youth sports complex, within its City limits ("Project"); and

WHEREAS, City expects to pay certain expenditures ("Reimbursement Expenditures") in connection with the Project prior to the issuance of indebtedness for the purpose of financing costs associated with the Project on a long-term basis; and

WHEREAS, the City reasonably expects that debt obligations in an amount not expected to exceed $16,000,000 will be issued and that certain of the proceeds of such debt obligations will be used to reimburse the Reimbursement Expenditures.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Lodi that:

Section 1. City finds and determines that the foregoing recitals are true and correct.

Section 2. This declaration is made solely for purposes of establishing compliance with the requirements of Section 1.150-2 of the Treasury Regulations. This declaration does not bind City to make any expenditure, incur any indebtedness, or proceed with the Project.

Section 3. City hereby declares its official intent to use proceeds of indebtedness to reimburse itself for Reimbursement Expenditures.

Section 4. This resolution shall take effect from and after its adoption.

Dated: June 6, 2001

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I hereby certify that Resolution No. 2001-146 was passed and adopted by the Lodi City Council in a regular meeting held June 6, 2001 by the following vote:

AYES: COUNCIL MEMBERS – Howard, Land, Pennino and Mayor Nakanishi

NOES: COUNCIL MEMBERS – Hitchcock

ABSENT: COUNCIL MEMBERS – None

ABSTAIN: COUNCIL MEMBERS – None

Susan J. Blackston

SUSAN J. BLACKSTON
City Clerk

RESOLUTION NO. 2001-147

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF LODI DECLARING ITS INTENT TO REIMBURSE CERTAIN EXPENDITURES FROM PROCEEDS OF INDEBTEDNESS (GENERAL GOVERNMENT FACILITIES)

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WHEREAS, the City of Lodi ("City") intends to construct general government facilities consisting of an Animal Shelter and a Parking Structure, and associated facilities within its City limits ("Project"); and

WHEREAS, City expects to pay certain expenditures ("Reimbursement Expenditures") in connection with the Project prior to the issuance of indebtedness for the purpose of financing costs associated with the Project on a long-term basis; and

WHEREAS, the City reasonably expects that debt obligations in an amount not expected to exceed $8,000,000 will be issued and that certain of the proceeds of such debt obligations will be used to reimburse the Reimbursement Expenditures.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Lodi that:

Section 1. City finds and determines that the foregoing recitals are true and correct.

Section 2. This declaration is made solely for purposes of establishing compliance with the requirements of Section 1.150-2 of the Treasury Regulations. This declaration does not bind City to make any expenditure, incur any indebtedness, or proceed with the Project.

Section 3. City hereby declares its official intent to use proceeds of indebtedness to reimburse itself for Reimbursement Expenditures.

Section 4. This resolution shall take effect from and after its adoption.

Dated: June 6, 2001

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I hereby certify that Resolution No. 2001-147 was passed and adopted by the Lodi City Council in a regular meeting held June 6, 2001 by the following vote:

AYES: COUNCIL MEMBERS – Howard, Land, Pennino and Mayor Nakanishi

NOES: COUNCIL MEMBERS – Hitchcock

ABSENT: COUNCIL MEMBERS – None

ABSTAIN: COUNCIL MEMBERS – None

Susan J. Blackston

SUSAN J. BLACKSTON
City Clerk